No. 12894

In the United States Court of Appeals for the Ninth Circuit

UNITED STATES OF AMERICA,
Appellant,

v.

PACIFIC ABSTRACT TITLE CO.,
a Corporation,
Appellee.

On Appeal from the United States District Court
for the District of Oregon

BRIEF FOR THE UNITED STATES

THERON LAMAR CAUDLE,
Assistant Attorney General
ELLIS N. SLACK,
LEE A. JACKSON,
HARRY MARSELLI,
LELAND T. ATHERTON,
Special Assistants to the Attorney General.

HENRY L. HESS,
United States Attorney.
VICTOR E. HARR,
Assistant United States Attorney
Of Counsel.

GLASS-KEYSTONE PRESS

INDEX

INDEX

CITATIONS

Page

CASES:

CITATIONS—Continued

CITATIONS—Continued

No. 12894

In the United States Court of Appeals for the Ninth Circuit

UNITED STATES OF AMERICA,
Appellant,
v.
PACIFIC ABSTRACT TITLE CO.,
a Corporation,
Appellee.

On Appeal from the United States District Court
for the District of Oregon

BRIEF FOR THE UNITED STATES

THERON LAMAR CAUDLE,
Assistant Attorney General
ELLIS N. SLACK,
LEE A. JACKSON,
HARRY MARSELLI,
LELAND T. ATHERTON,
Special Assistants to the Attorney General.

HENRY L. HESS,
United States Attorney.
VICTOR E. HARR,
Assistant United States Attorney
Of Counsel.

OPINION BELOW

The District Court did not write any formal opinion but made special findings of fact and conclusions of law which are not officially reported. These findings of fact and conclusions of law will be found in the record (pp. 25-30).

JURISDICTION

This appeal involves federal income tax for the year 1945 in the amount of $18,805.19, plus interest. The tax in controversy was a deficiency determined by the Commissioner of Internal Revenue after audit of the taxpayer's income tax return for the calendar year 1945 in the amount of $15,979.27, which deficiency was duly paid with accrued interest of $2,825.92 on March 24, 1949, to J. W. Maloney, then Collector of Internal Revenue for the District of Oregon, which Collector is no longer in office. (R. 27-28.) Taxpayer filed a claim for refund of the tax involved in this controversy on or about June 20, 1949. (R. 28.) The Commissioner of Internal Revenue has not acted on taxpayer's claim for refund and at the time this action was instituted in the District Court more than six months had elapsed since the filing of taxpayer's claim for refund. (R. 28.)

Within the time provided in Section 3772 of the Internal Revenue Code and on March 1, 1950, the taxpayer filed a complaint in United States District Court for the District of Oregon for the recovery of the tax paid involved in this

controversy. (R. 3, 12, 34.) Jurisdiction was conferred on the District Court by 28 U. S. C., Section 1346 (a)(1). Judgment was entered for the taxpayer on November 17, 1950. (R. 30-31.) Within sixty days and on January 11, 1951, a notice of appeal was filed. (R. 31-32.) The jurisdiction of this Court is necessarily invoked under 28 U. S. C., Section 1291.

QUESTION PRESENTED

Whether the District Court erred in allowing the taxpayer, a title insurance company, an exclusion from its gross underwriting income for the taxable year 1945 under Section 204 (b)(5) of the Internal Revenue Code in the amount of $18,614.63, representing 3% of the total title insurance premiums received by taxpayer on account of title insurance contracts written by it during the four calendar years 1942 to 1945, inclusive.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations involved will be found in the Appendix, *infra,* pp.

STATEMENT

The undisputed facts as found by the District Court (R. 25-28) and as set forth in the pleadings (R. 3-15) may be briefly summarized as follows:

Taxpayer is a domestic corporation and a citizen of the United States residing at Portland, Oregon. (R. 25.) At all the times herein involved, the taxpayer was carrying on the business of insuring titles to real property for compensation in the business commonly known as a title insurance business, and was subject to the Insurance Code of the State of Oregon, being 7 Oregon Compiled Laws Annotated (1940 ed.), Sections 101-101 through 101-1803. (R. 4, 13.)

During the year 1945, the Insurance Commissioner of the State of Oregon, through his duly appointed agents, examined taxpayer's books and on January 12, 1946, ordered it under and by virtue of Sections 101-136 and 101-137, Oregon Compiled Laws Annotated, to establish, segregate and maintain an unearned premium of reinsurance reserve which shall at all times and for all purposes constitute unearned portions of the premiums and shall be charged as a reserve liability of the corporation in its statement. The Insurance Commissioner ordered that such reserves shall be accrued and consist, as at December 31, 1945, for the years 1942, 1943, 1944 and 1945, of an amount equal to 3% of the total gross fees and premiums received or to be received by taxpayer on account of policies issued during those calendar years, and thereafter monthly at the close of each month, beginning Janaury, 1946, 3% of the total gross fees and premiums received or to be received on account of policies written during the preceding calendar month, and after the expiration of 180 months from January 1, 1942,

that portion of the unearned premiums or reinsurance reserves established more than 180 months prior shall be released and shall no longer constitute part of the unearned premium or reinsurance reserve and may be used for any corporate purpose. (R. 26-27.) Accordingly, taxpayer set upon its books, as aforementioned, on December 31, 1945, a reserve for purported unearned premiums as follows: 3% of 1942 premiums, $2,780.17; 3% of 1943 premiums, $3,-885.46; 3% of 1944 premiums, $4,829.59; 3% of 1945 premiums, $7,119.41. Total reserves, $18,614.63. (R. 28.)

On or about November 22, 1948, the Commissioner of Internal Revenue determined that the exclusion shown in taxpayer's income tax return for the calendar year 1945 of the $18,614.63, aforementioned, as a reserve set up by taxpayer on its books as of December 31, 1945, was improper and excluded the amount of the reserve in determining the taxpayer's tax liability for the calendar year 1945. The Commissioner recomputed the taxpayer's income tax liability for the year 1945 on the basis of the adjustment, aforementioned, and determined a deficiency in income tax for that year in the amount of $15,979.27, which deficiency in tax was duly assessed and was paid with accrued interest of $2,825.92 on March 24, 1949, to J. W. Maloney who was then Collector of Internal Revenue. (R. 27-28.)

On or about June 20, 1949, taxpayer filed a claim for refund of the deficiency in income tax collected from it for

the calendar year 1945, together with the interest assessed thereon, on the ground that the reserve which it was required to set up in accordance with the directive of the Insurance Commissioner of Oregon was legally set up by the State of Oregon and was taken away from the jurisdictional authority of the board of directors of the taxpayer and, therefore, was not available to it as surplus or for the payment of dividends to its stockholders. (R. 28.) At the time the suit was instituted in the District Court, more than six months had elapsed since the filing of the taxpayer's claim for refund upon which that suit was predicated. (R. 28.)

STATEMENT OF POINTS TO BE URGED

In the present appeal, the United States urges and relies upon all of the points originally stated by it (R. 52-54) and subsequently adopted by it in this Court (R. 55) as the points upon which it intends to rely. For present purposes, they may be briefly summarized as follows:

1. The District Court erred in concluding that the Insurance Commissioner of Oregon had authority under the laws of Oregon to order the taxpayer to set up on its books as of December 31, 1945, the reserve in question, in the amount of $18,614.63, as a purported reserve for "unearned premiums", computed upon the taxpayer's premiums for the years 1942 to 1945, inclusive.

2. The District Court erred in concluding that the amount of the reserve in question was an allowable reserve under Section 204 (b) (5) of the Internal Revenue Code.

3. The District Court erred in concluding that the Commissioner of Internal Revenue was in error in restoring the amount of the reserve in question to the taxpayer's gross income for the year 1945, in determining the taxpayer's tax liability for that year.

4. The District Court erred in failing to hold that the amount of $18,614.63 computed by the taxpayer in accordance with the directive of the Insurance Commissioner of Oregon did not constitute "unearned premiums" and was not allowable as a reserve under Section 204 (b) (5) of the Internal Revenue Code.

SUMMARY OF ARGUMENT

Congress intended the words "unearned premiums", as used in Section 204 (b) (5) of the Internal Revenue Code, to be given their usual and ordinary meaning as known and understood in the business of insurance—namely, that portion of the premium received which the company had not had time to earn during the taxable year. The taxpayer's reserve, which it was required to set up by the directive of the Insurance Commissioner of the State of Oregon, did not constitute "unearned premiums" within the meaning of Section 204 (b) (5) of the Internal Revenue Code.

The title insurance policies issued by the taxpayer during the calendar years involved do not contain any requirement or provision for the return to the policyholder of any portion of the premium collected. The applicable provisions of the Insurance Code of Oregon, upon which the Insurance Commissioner acted, do not define "unearned premiums" in the case of title insurance companies; and do not require the taxpayer to maintain a "reserve" for unearned premiums. The Oregon Insurance Code merely provides that in ascertaining the condition of an insurance company and in ascertaining its liabilities there shall be charged, among other things, a sum equal to the total unearned premiums on policies in force computed on a pro rata basis, and such an amount as may be found necessary as a reserve to provide for the future payment of deferred and undetermined claims for losses and promised benefits. In the case of title insurance, the entire premium is earned when the policy is issued. Accordingly, to the extent that the Insurance Commissioner's directive purported to impose the burden of maintaining an unearned premium reserve upon this taxpayer, it clearly transcended the power which the Oregon legislature delegated to him. Moreover, it was beyond the power of the Insurance Commissioner after the close of the calendar year 1945 to convert *retroactively* any portion of premiums previously fully earned by the taxpayer into unearned premiums held by it at the beginning and end of each of the calendar years 1942 to 1945, inclusive.

ARGUMENT

The taxpayer was not entitled to a deduction under Section 204 (b) (5) of the Internal Revenue Code for the reserve required to be maintained by the directive of the Insurance Commissioner of Oregon purportedly as a reserve for "unearned premiums".

We are dealing in this case with a title insurance corporation organized under the laws of the State of Oregon which has, since its formation, been engaged in the business of insuring the owners of real estate, or those having interest in real estate by mortgage, or otherwise, from loss by reason of defective titles, liens or incumbrances.

It is no longer open to question that companies guaranteeing land titles for a consideration are taxable as insurance companies. *United States* v. *Home Title Co.,* 285 U. S. 191. The taxpayer in the case at bar for the calendar years 1942, 1943, 1944 and 1945 was taxable for federal income tax purposes under the provisions of Section 204 of the Internal Revenue Code (Appendix, *infra*) as an insurance company, other than life or mutual.

The controversy in this case involves the construction of Section 204 of the Internal Revenue Code. That section of the Code was derived from Section 246 of the Revenue Act of 1921, c. 136, 42 Stat. 227. The section was re-enacted, without material change, in each of the subsequent Revenue Acts to and including the Revenue Act of 1938, and on

February 10, 1939, was incorporated into the Internal Revenue Code.

The general scheme of Section 204 of the Code is to divide the income of insurance companies subject to tax thereunder into three groups, namely, the investment income, underwriting income, and all other income. Only the taxpayer's underwriting income is involved in this case, and the particular problems in controversy relate to the computation of "premiums earned." Paragraph (4) of subsection (b) of Section 204 defines "underwriting income" as the "premiums earned" less "losses incurred" and "expenses incurred." Paragraph (5) defines "premiums earned" as "an amount computed as follows":

> "From the amount of gross premiums written on insurance contracts during the taxable year, deduct return premiums and premiums paid for reinsurance. To the result so obtained add unearned premiums on outstanding business at the end of the preceding taxable year and deduct unearned premiums on outstanding business at the end of the taxable year. * * *"

Thus, in order to compute "premiums earned" during the taxable year, it is necessary to reflect the net changes during the year in the amount of "unearned premiums." The particular issue in controversy in this case is as to whether the reserve in question constituted "unearned premiums" at all, so as to permit the increase therein during the taxable year—i.e., the entire amount of $18,614.63, inasmuch as there was no such reserve at the beginning of the

year—to be used to reduce "premiums earned" during the taxable year.

The controversy also involves the construction, validity, and enforceability of the so-called directive contained in a letter dated January 12, 1946, addressed to this taxpayer by the Insurance Commissioner of Oregon. The pertinent provisions of this so-called directive read as follows (R. 38-39, Pre-Trial Ex. 1):

> "1. The Pacific Abstract Title Company shall establish, segregate and maintain an unearned premium or reinsurance reserve as hereafter provided, which shall at all times and for all purposes be deemed and shall constitute unearned portions of the premiums and shall be charged as a reserve liability of your corporation in your statements; such reserve shall be cumulative and shall be established and shall consist of the following:
>
> (a) As at December 31, 1945 or within a period of three years thereafter an amount equal to 3% of the total gross fees and premiums received or to be received on account of policies issued during the four calendar years—1942, 1943, 1944 and 1945; and
>
> (b) Monthly at the close of each month beginning January, 1946, 3% of the total gross fees and premiums received or to be received on account of policies written during the preceding calendar month;
>
> (c) After the expiration of 180 months from January 1, 1942, that portion of the unearned premium or reinsurance reserve established more than 180 months prior shall be released and shall no longer constitute

> part of the unearned premium or reinsurance reserve and may be used for any corporate purposes. (R. 37-40, Pre-Trial Ex. 1.)"

There is involved here the effectuality of the Insurance Commissioner's directive in respect to the determination of this taxpayer's taxable income from insurance business for the taxable year 1945 under Section 204 of the Internal Revenue Code.

We are also concerned here with the interpretation and extent of the delegated powers conferred upon the Oregon Insurance Commissioner by the Oregon Insurance Code. (7 Oregon Compiled Laws Annotated, Sections 101-105, 101-136, 101-137 and 101-138 (Appendix, *infra*)).

1. Congress, in enacting Section 246 (b)(5) of the Revenue Act of 1921, and the corresponding provisions of subsequent Revenue Acts including Section 204 (b)(5) of the Internal Revenue Code, intended the words "unearned premiums" to be given their usual and ordinary meaning as known and understood in the business of insurance. In *DeGanay* v. *Lederer,* 250 U.S. 376, 381, it is said:

> "Unless the contrary appears, statutory words are presumed to be used in their ordinary and usual sense, and with the meaning commonly attributable to them."

There is nothing in the section here under consideration to show that Congress used the words "unearned premiums" in other than their usual and ordinary sense as known and understood in the business of insurance.

The word "premium" as applied to insurance contracts has been defined as "the price or amount paid for insurance" (Funk & Wagnall's Standard Dictionary), or as "the consideration paid for a contract of insurance" (Bouvier's Law Dictionary); while the word "unearned" is defined in Webster's New International Dictionary (1933) to mean "not earned; not gained by labor or service."

A good statement of the meaning of "unearned premiums" was made in *Aetna Ins. Co.* v. *Hyde,* 315 Mo. 113, 133, where the words were held to mean that portion of the premium paid by the policyholder which must be returned on cancellation of the policy, and which is in direct proportion to the unexpired time which the policy is to run. The court said (p. 133):

> "They are paid in advance for service to be thereafter rendered. *That is, it is what a company must repay when it cancels a policy."* (Italics supplied.)

Solomon S. Huebner, Ph.D., professor of insurance and commerce, University of Pennsylvania, in his work, Property Insurance, c. XIV, pp. 153-154, puts it this way:

> "Thus let us suppose that a company issues an annual policy for a premium of $120. This premium is payable in advance, and since the policy has a year to run, it is clear that the company has not yet earned this sum, but will become entitled to it only in the proportion that the policy reaches its maturity. At the end of the first month one-twelfth of the term has elapsed, and the company can rightfully consider that

part of the premium, or $10, as earned. Eleven-twelfths of the premium, however, or $110, must be considered unearned, since the company has not yet furnished protection for the eleven months remaining in the term. At the end of six months one-half of the premium, or $60, is earned, and the other half unearned. It is not until the end of the twelfth month that the company has furnished the full year's insurance, and is, therefore, entitled to the full premium.

This unearned portion of the premium constitutes the reserve. It must be regarded as a sum held in trust by the company for its policyholders. Although paid to it in advance, the company cannot claim this sum as its own property. It belongs to the policyholders, and must be earned by the company before it can be used for its own purposes. The reinsurance reserve may thus be defined as 'the unearned premium'; or as the liability of the company to its policyholders for that portion of the premium already collected, but not yet earned.[1]"

That the words "unearned premiums" in insurance and actuarial circles had a well-known and commonly understood meaning when Congress enacted the Revenue Act of 1921 will not, it is believed, be disputed. These words were generally known and understood to mean that portion of the premium paid for the unexpired portion of the term, which the company had not yet had time to earn.

---

[1] While Professor Huebner was here discussing the unearned premium of a fire insurance company, the same principles apply to all casualty insurance, including accident and health insurance.

In speaking of "This unearned portion of the premium", Professor Huebner remarked:

> "It belongs to the policyholders, and must be earned by the company before it can be used for its own purposes."

Clearly, the converse must be true. If any portion of the "premium" *does not belong to the policyholder,* then it must belong to the company.

An inspection of the form of title insurance policies issued by the taxpayer during the period here involved (R. 45-51, Pre-Trial Ex. 8) will disclose that this policy did not contain any requirement or provision for the return to the policyholder of any portion of the premium collected. So, we submit that no portion of the taxpayer's premiums written on insurance contracts during the period involved in this law suit could be "unearned" as the insured was not entitled to any return of the premiums so collected. Since, in the case at bar, a policyholder has no claim against the taxpayer for the return of any portion of his premium *qua* premium, it seems clear that the premium, when paid, must belong to the insurance company, and hence, is fully earned when paid.

The position of the court below is erroneously based on the fallacious premise that the so-called directive of the Insurance Commissioner of Oregon effectually and retroactively converted into "unearned premiums" in 1945 portions of the premiums previously collected and actually earned

by the taxpayer during the years 1942 and 1944, inclusive, as well as portions of those collected and earned by it during the calendar year 1945.

The provisions of Section 204 (b)(5) of the Internal Revenue Code which in effect require the division of premiums charged by insurance companies into earned and unearned premiums are not applicable to title companies whose premiums are earned in full at the time their policies are issued. Earnings of title companies are returnable for income tax purposes in the year the charge for their services is made, if, like the taxpayer here, they keep their books and make their income tax returns on the accrual basis of accounting. *American Title Co.* v. *Commissioner,* 76 F. 2d 332 (C.A. 3d), affirming 29 B.T.A. 479; *North American Reassurance Co.* v. *Commissioner,* 29 B.T.A. 683; *Commissioner* v. *Dallas Title & Guar. Co.,* 119 F. 2d 211 (C.A. 5th); *City Title Ins. Co.* v. *Commissioner,* 152 F. 2d 859 (C.A. 2d). Cf. *Massachusetts Protective Ass'n* v. *United States,* 114 F. 2d 304 (C.A. 1st).

In *Massachusetts Protective Ass'n* v. *United States, supra,* the Court of Appeals called attention to the difference between the nature of the business conducted by certain kinds of insurance companies, other than life or mutual, based on the character and length of the risks against which the policyholder was insured. See, for example, the following excerpt from the court's opinion in the case (p. 312):

> "Whether a premium is considered earned or unearned depends upon the nature of the risk and policy involved. *American Title Co.* v. *Commissioner,* 1933, 29 B.T.A. 479, affirmed 3 Cir., 1935, 76 F. 2d 332. Fire and ordinary casualty insurance premiums become fully earned as soon as the period for which the premium was paid has expired, for the risk expires at the same time; but a title insurance premium is fully earned the moment it is paid although the risk continues indefinitely. *American Title Co.* v. *Commissioner, supra.* See Mass. Gen. Laws (Ter. Ed. 1932) c. 175, Sec. 10; Huebner, Property Insurance (1927) 355."

Again, in *American Title Co.* v. *Commissioner,* the Board of Tax Appeals said (p. 481):

> "Unlike other insurance, such as life, fire, etc., which protect the insured against future events, title insurance merely guarantees against a future disclosure of unfavorable circumstances existing at the time of the deed."

In view of the inherent nature of the risk against which title companies insure their policyholders, it is not possible to allocate a part of the premium charged for a policy to "unearned premiums" and set it up in a so-called *unearned premium reserve* upon any basis of fact. Cf. *Commissioner* v. *Dallas Title & Guar. Co., supra.*

Under Section 204 of the Internal Revenue Code, the total of the taxpayer's gross fees involved represents income which was fully earned and *accrued* during the year 1945. See Section 204 (b) (1) which defines gross income. And,

of course, it is needless to reiterate that all *gross fees* charged by the taxpayer in 1942, 1943, 1944 and 1945 were fully earned at the time it (1) performed the service, or (2) assumed the risks for which it billed its policyholders. *American Title Co.* v. *Commissioner,* 76 F. 2d 332 (C.A. 3d), affirming 29 B.T.A. 479.

2. Sections 101-136, 101-137, and 101-138 of the Oregon Compiled Laws Annotated, which relate to insurance laws generally, frequently called the Oregon Insurance Code, do not require the taxpayer to maintain a "reserve" for unearned premiums. The applicable provisions of that insurance code, upon which the Insurance Commissioner of Oregon acted, do not define "unearned premiums" in the case of title insurance companies. That insurance code merely provides that in ascertaining the condition of an insurance company and in ascertaining its liabilities there shall be charged, among other things, a sum equal to the total unearned premiums on policies in force computed on a pro rata basis, and such an amount as may be found necessary as a reserve to provide for the future payment of deferred and undetermined claims for losses and promised benefits. Accordingly, we submit that, to the extent that the Insurance Commissioner's directive purported to impose the burden upon this taxpayer, a title insurance company, of maintaining an unearned premium reserve, that directive clearly transcended the power which the Oregon Legislature delegated to him.

Avoiding the temptation to apply technical tests for construing statutes to the language the lawmakers employed in framing Sections 101-136, 101-137 and 101-138 of the Oregon Insurance Code, and applying to it merely the usual and ordinary meaning of the language used, it seems to be reasonably clear that the only authority the State of Oregon delegated to its Insurance Commissioner was: (1) to make examinations; (2) to ascertain the assets and liabilities of the insurance companies according to standards prescribed; and (3) with the assistance of the courts to take steps against those companies which the Commissioner ascertained to be insolvent or in unsound condition. We think the employment of the term "unearned premiums" in Section 101-137 is not indicative of any principles to the contrary.

The directive of the Oregon Insurance Commissioner which was issued on January 12, 1946, after this taxpayer had earned its premiums with respect to business written during the calendar years 1942, 1943, 1944 and 1945 purported to divest this taxpayer of a part of those premiums upon the supposititious fiction that a portion of the premiums collected belonged to the policyholders and should be held in trust for such policyholders. While it is true that Section 101-137 of the Oregon Insurance Code provides that in determining the *amount* of "unearned premiums", the Insurance Commissioner, his deputy or examiner may formulate such rules as he may deem proper and consistent

with law or he may adopt such rules as are used in other states or approved by the National Convention of Insurance Commissioners, certainly that authority did not confer upon the Insurance Commissioner the power to convert retroactively, after the close of the calendar year 1945, any part of premiums previously fully earned by the taxpayer into unearned premiums held by it at the beginning and end of each of the calendar years beginning with 1942 through 1945. So, we maintain that the Insurance Commissioner's directive of January 12, 1946, was an attempt to legislate and not merely to exercise an administrative function or discretion which the Oregon Insurance Code conferred upon him, and therefore is void. *Sunshine Dairy* v. *Peterson,* 183 Or. 305.

In that case, the Sunshine Dairy questioned the authority of the Director of Agriculture to fix minimum wholesale and retail prices for milk as charged by producers, distributors, and dealers, etc., under the state Milk Control Act. The Act conferred very broad powers upon the director, but the Supreme Court of Oregon held, nevertheless, in a lengthy opinion which reviewed most of the state and federal authorities, that the directive exceeded the authority of the director. In the course of its opinion, the court referred to one of its earlier decisions in the following manner (p. 327):

> "In the more recent case of *Layman* v. *State Unemployment Compensation Commission,* 167 Or. 379, 117

P. (2d) 974, 136 A.L.R. 1468, the court said:

> " 'It is an elementary and fundamental principle, which no one will dispute, that a commission, created by the legislature to administer a statute, is wholly limited in its powers and authority by the law of its creation. No more unwholesome doctrine could be suggested than that such a body is vested with discretion to ignore or transgress these limitations even to accomplish what it may deem to be laudable ends. That would be to leave room for that "play and action of purely personal and arbitrary power" condemned in *Yick Wo* v. *Hopkins,* 118 U. S. 356, 6 S. Ct. 1064, 30 L. Ed. 220, 226. If the statute as written is not workable, then the remedy is with the legislature. * * *' "

Cf. *Social Security Board* v. *Nierotko,* 327 U. S. 358, holding that where Government officials interpret a statute so as to make it apply to particular circumstances as a delegation of legislative power, their directives must have a basis in law and must be within the authority granted; and *Bartels* v. *Birmingham,* 332 U. S. 126, which holds that an interpretative ruling of the Commissioner of Internal Revenue that a statement in a contract for services between the operator of a place of amusement and the leader of a band of musicians, that the former is the employer of the musicians and their leader, and shall have complete control of the services to be rendered by them, makes such operator liable as the employer for the employment tax imposed under the Social Security Act, exceeds the statutory power of the Commissioner.

Section 101-137 of the Oregon Insurance Code merely gives the Insurance Commissioner authority to determine the *amount* of unearned premiums in the case of insurance companies which, unlike title insurance companies, do have "unearned premiums" because of the nature of their business. As to those companies the statute leaves it to the Insurance Commissioner to determine a formula upon which to calculate the portion of their premiums which is unearned and which is to be set aside as a reserve, and that is not an improper delegation of powers. Cf. *Field* v. *Clark,* 143 U. S. 646, 694. See also, *Van Winkle* v. *Fred Meyer, Inc.,* 151 Ore. 455, 462.

The question whether there has been an improper delegation of legislative power to an administrative official or body is always made to turn on whether the legislature has fixed a proper standard for their guidance. Cf. *State* v. *Briggs,* 45 Or. 366; *State Ex Rel.* v. *Malheur County Court,* 185 Or. 392, 422; *Pittsburgh Glass Co.* v. *Labor Board,* 313 U. S. 146; *American Power Co.* v. *S. E. C.,* 329 U. S. 90.

As the terms "reserve" or "reserves", including "unearned premium reserve," have a well established meaning in the field of insurance, (*Maryland Casualty Co.* v. *United States,* 251 U. S. 342, 351), the Oregon legislature must be deemed to have used those terms in Section 101-137, Oregon Compiled Laws Annotated, in their established technical sense, and that left no room for the Insurance Commissioner to declare any portion of the premiums of title companies

to be "unearned premiums". So, when the Insurance Commissioner undertook to direct this taxpayer, a title insurance company, to set up the disputed reserve, we submit that he exceeded his authority, as the Social Security Board did in the case of *Social Security Board* v. *Nierotko,* 327 U. S. 358, in that the Insurance Commissioner of Oregon erroneously ruled that a portion of the premiums collected by title insurance companies was unearned.

The intention of Congress controls on the question of whether the federal or state law is to be applied. *Helvering* v. *Stuart,* 317 U. S. 154. Manifestly, the mere declaration that a thing is a fact when the evidence which must be offered in its support discloses the contrary to be the case, is not binding on the Commissioner of Internal Revenue. *Early* v. *Lawyers Title Ins., Corp.,* 132 F. 2d 42 (C.A. 4th).

The text of the Virginia Statute is quoted by the Court of Appeals in the *Early* case (p. 43) and reads as follows:

> "(e) On any contract of title insurance, hereafter issued by a domestic title insurance company, there shall be reserved initially a sum equal to ten per centum of the original premium, whether or not the risk shall be for a fixed time. If for a fixed time, then at the end of each year for the first five years, there shall be a reduction in the sum reserved of one per centum of the original premium, and thereafter at the end of each year of the remainder of said time a reduction of a pro-rata portion of the remaining five per centum thereof, except that if the risk is of a mortgagee, trustee in a deed of trust to secure debt, or creditor secured thereby,

no reduction shall be made that will decrease the sum reserved below five per centum of the original premium, until the expiration of the time of the risk. If not for a fixed time, then a risk shall be deemed to have been written, if of an owner of property, or any interest therein, for twenty years from the date of the contract, and if of a mortgagee, trustees in a deed of trust to secure debt, or creditor secured thereby, for a time expiring three years after the final maturity of the debt as stated in the mortgage or deed of trust, or for twenty years from the date of the contract, whichever time shall be longer. On any contract of title insurance heretofore issued, a reserve shall be set up and hereafter maintained, in such sum as would have been required if the above requirements had existed at and after the date of the contract. *Said sums, herein required to be reserved for unearned premiums on contracts of title insurance shall at all times and for all purposes be considered and constitute unearned portions of the original premiums.* In calculating reserves, contracts of title insurance shall be assumed to be dated in the middle of the year in which they were issued." (Italics supplied.)

In the course of its opinion in the *Early* case, the Court of Appeals for the Fourth Circuit said: (1) That ordinarily a premium paid for title insurance is to be treated as fully earned when received, citing *American Title Co.* v. *Commissioner,* 76 F. 2d 332 (C.A. 3d), affirming 29 B.T.A. 479, and Huebner, Property Insurance, c. XXX, p. 493, and (2) That in the absence of a statute comparable to that of Virginia, it would feel constrained to hold that no part of the premiums paid by the taxpayer could be treated as "un-

earned" within the meaning of the revenue laws. After stating that a state statute could not be given the effect of withdrawing from taxation what is in fact an earned premium by the mere device of calling it unearned, the court concluded that the Virginia statute gave to the amounts reserved all the attributes that pertain to unearned premiums, i.e., it withdrew them from the power of the company to use them for its general purposes and impressed them with a trust in favor of contract holders until the risks shall have been carried for the period that the statute prescribed. But there is no provision in Sections 101-136 and 101-137 of the Oregon Insurance Code comparable to the provisions of the Virginia statute.

Since the charges the instant taxpayer made for its services during the years 1942, 1943, 1944 and 1945 were properly accrued as income during each of those years, the fact that it was directed on January 12, 1946, undoubtedly to provide greater assurance with respect to its future solvency for the protection of its policyholders, would not, and could not alter its liability for federal income taxes if they were correctly determined otherwise on an annual basis. Accordingly, it is submitted that the total amount involved represents premiums earned (accrued) and not premiums unearned during the year 1945 under Section 204 (b) (5) of the Internal Revenue Code. Accordingly,

we maintain that the District Court erred in holding that the Commissioner of Internal Revenue improperly restored the amount of the disputed reserve to the taxpayer's taxable income for the year 1945.

3. Congress, in enacting Section 204 (b)(5) of the Internal Revenue Code, made no provision in the case of an insurance company, other than life or mutual, for the deduction of any reserve whatever. The deductions from gross income granted by Congress to insurance companies, other than life or mutual, by the Internal Revenue Code are listed in detail in Section 204 (c) (1) to (10), inclusive. There is no provision therein contained for the deduction by such companies of an insurance reserve of any kind.

This is particularly significant since in the preceding Section 201 of the Internal Revenue Code (26 U.S.C. 1946 ed., Sec. 201), pertaining to life insurance companies, as well as in the succeeding Section 207 of the Internal Revenue Code (26 U.S.C. 1946 ed., Sec. 207), pertaining to mutual insurance companies, other than life and marine, there are expressly set forth provisions for the deduction of reserve funds required by law in the case of those companies. The omission was deliberate. Prior to the enactment of the Revenue Act of 1921, all insurance companies were permitted to deduct from gross income "the net addition, if any, required by law to be made within the year to reserve

funds."[2] That deduction was eliminated by Congress, however, in the case of insurance companies, other than life or mutual, after December 31, 1921, by Section 234 (a) (10) of the Revenue Act of 1921, providing as follows:

> "SEC. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:
>
> * * * * * *
>
> (10) In the case of insurance companies (other than life insurance companies), in addition to the above (unless otherwise allowed): (A) The net addition required by law to be made within the taxable year to reserve funds (including in the case of assessment insurance companies the actual deposit of sums with State or Territorial officers pursuant to law as additions to guarantee or reserve funds); and (B) The sums other than dividends paid within the taxable year on policy and annuity contracts. After December 31, 1921, this subdivision shall apply only to mutual insurance companies other than life insurance companies; * * *"

Nowhere in the Internal Revenue Code, as already stated, is there any provision for the deduction of any reserve in the case of companies of the type here in question. Accordingly, we maintain that the deduction claimed by the

---

[2] Corporation Excise Tax Act of 1909, c. 6, 36 Stat. 11, 113, Section 38 (Second); Income Tax Act of 1913, c. 16, 38 Stat. 114, 172-173, Section IIG (b) (Second); Revenue Act of 1916, c. 463, 39 Stat. 756, 767-768, Section 12(a) (Second) (c); Revenue Act of 1918, c. 18, 40 Stat. 1057, 1077-1079, Section 234(a) (10).

taxpayer should have been denied by the District Court, even though the amounts which it was required by the rule of the Insurance Commissioner of Oregon to segregate and maintain in the reserve for alleged unearned premiums were wholly set aside and taken away from the jurisdiction of its board of directors and were not available to it as surplus for the payment of dividends to its stockholders during that period. Whether this reserve required by rule of the Insurance Commissioner of Oregon purportedly as an "unearned premium" reserve might possibly be a valid reserve of another character under the Oregon statute is immaterial, because the taxpayer—an insurance company other than life or mutual—is not entitled to deduct any reserves in the computation of its taxable income. *American Title Co.* v. *Commissioner, supra; Pacific Employers Insurance Co.* v. *Commissioner,* 89 F. 2d 186 (C.A. 9th).

4. If, contrary to our argument above, it were held that the directive of the Insurance Commissioner of Oregon was valid, such a holding, we believe, would necessarily have to be based on an erroneous conclusion that the Oregon statute did not use the term "unearned premiums" in the well-established meaning of that term. But the conclusion, whether erroneous or not, that the term "unearned premiums" is not used in its ordinary sense in the Oregon statute would preclude a holding that the present taxpayer is entitled to any deduction or exclusion under the federal taxing statute which in Section 204 (b)(5) provides for

the exclusion from underwriting income of "unearned premiums", for it may not be controverted that the term "unearned premiums" is used in the federal statute in the ordinary sense in which that term is understood in the insurance industry and as such excludes premiums on title insurance, which are fully earned when policies are written.

Moreover, even if the assumption be made that some part of title insurance premiums may by directive of a state official be given all of the attributes of "unearned premiums", this does not mean, and cannot mean, that a reserve may be set up in one year for all policies theretofore written by the company, during its entire life or a portion thereof, and have that reserve treated as "unearned premiums" on the policies written during the year in which the reserve for the first time is established.

The federal taxing statutes are based, as is so well-known as to require no citation, on an annual system of tax accounting. Prior to the issuance on January 12, 1946, of the directive of the Insurance Commissioner of Oregon to the present taxpayer there was no ground whatsoever for contending that the premiums received by taxpayer for the writing of title policies were not fully earned when the policies were written. The risk was not a continuing one for a prescribed period of time, but was a single risk incurred at the time the policy was written and for which risk the premium was intended to compensate. No portion of the premiums re-

ceived was returnable to the contract holders *qua* premiums. The company had unfettered power to use those premiums for any of its general purposes and thus had full economic enjoyment of those amounts. Under no test, therefore, of the federal statute, as of the close of the taxable year 1945, could any portion of the premiums received or accrued in 1945 or any prior year be treated as unearned.

The requirement of the directive of January 12, 1946, issued by the Insurance Commissioner that taxpayer set up a reserve retroactively as of December 31, 1945, cannot change the federal tax consequences of events which had transpired prior thereto. Once the incidence of the federal tax has become fixed upon events which have actually transpired during the taxable year, the federal tax consequences of those events cannot thereafter be changed retroactively, for to do so would violate the principle of annual tax accounting to which we have adverted. Cf. *United States* v. *Lewis,* 340 U. S. 590.

Furthermore, the attempt by the taxpayer to reduce 1945 underwriting income by the entire amount of the reserve required by the directive of January 12, 1946, to be established as of December 31, 1945, and the holding of the court below sustaining that position of the taxpayer, constitute an unwarranted distortion of the underwriting income and tax liability of the taxpayer. That reserve, even if validly required and even though it might be given the

status of a reserve for unearned premiums, was not required to be established out of 1945 *income.* It was not a reserve established solely for holders of contracts written in 1945. It was a reserve for holders of all contracts, those written before 1945 as well as those written during 1945. It was in truth an arbitrary amount required to be set apart *from any appropriate funds* of the taxpayer, though in terms a percentage of the premiums received over the four-year period of 1942 to 1945, inclusive. The amount of the reserve could, and should, have been established out of the earned surplus of the company.

Respectfully submitted,

THERON LAMAR CAUDLE,
Assistant Attorney General.

ELLIS N. SIACK,
LEE A. JACKSON,
HARRY MARSELLI,
LELAND T. ATHERTON,
Special Assistants to the Attorney General.

HENRY L. HESS,
United States Attorney.

VICTOR E. HARR,
Assistant United States Attorney
Of Counsel.

July, 1951.

APPENDIX

Internal Revenue Code:

SEC. 204. INSURANCE COMPANIES OTHER THAN LIFE OR MUTUAL.

(b) *Definition of Income, Etc.*—In the case of an insurance company subject to the tax imposed by this section—

(1) [as amended by Section 135 of the Revenue Act of 1943, c. 63, 58 Stat. 21] *Gross income.*—"Gross income" means the sum of (A) the combined gross amount earned during the taxable year, from investment income and from underwriting income as provided in this subsection, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners, and (B) gain during the taxable year from the sale or other disposition of property, and (C) all other items constituting gross income under section 22; except that in the case of a mutual fire insurance company described in paragraph (1) of subsection (a) of this section, the amount of single deposit premiums paid to such company shall not be included in gross income;

(2) *Net income.*—"Net income" means the gross income as defined in paragraph (1) of this subsection less the deductions allowed by subsection (c) of this section;

* * * * *

(4) *Underwriting income.*—"Underwriting income" means the premiums earned on insurance contracts during the taxable year less losses incurred and expenses incurred;

(5) [as amended by Section 164 of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Premiums earned.*—"Premiums earned on insurance contracts during the taxable year" means an amount computed as follows:

From the amount of gross premiums written on insurance contracts during the taxable year, deduct return premiums and premiums paid for reinsurance. To the result so obtained add unearned premiums on outstanding business at the end of the preceding taxable year and deduct unearned premiums on outstanding business at the end of the taxable year. For the purposes of this subsection, unearned premiums shall include life insurance reserves, as defined in section 201(c)(2), pertaining to the life, burial, or funeral insurance, or annuity business of an insurance company subject to the tax imposed by this section and not qualifying as a life insurance company under section 201(b);

* * * * *

(26 U.S.C. 1946 ed., Sec. 204.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.204-1. *Tax on Insurance Companies Other Than Life or Mutual and Mutual Marine Insurance Companies.*—All insurance companies (other than life or mutual or foreign insurance companies not carrying on an insurance business within the United States) and all mutual marine insurance companies are subject to the tax imposed by section 204. * * * The net income of insurance companies is defined in section 204 and differs from the net income of other corporations. * * * Since section 204 provides that the underwriting and

investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners shall be the basis for computing gross income and since the annual statement is rendered on the calendar year basis, the returns under section 204 shall be made on the basis of the calendar year and shall be on Form 1120. * * *

* * * * *

SEC. 29.204-2. *Gross Income of Insurance Companies Other Than Life or Mutual and Mutual Marine Insurance Companies.* — Gross income as defined in section 204(b) means the gross amount of income earned during the taxable year from interest, dividends, rents, and premium income, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners, as well as the gain derived from the sale or other disposition of property, and all other items constituting gross income under section 22. * * * The underwriting and investment exhibit is presumed clearly to reflect the true net income of the company, and in so far as it is not inconsistent with the provisions of the Internal Revenue Code will be recognized and used as a basis for that purpose. * * * In computing "premiums earned on insurance contracts during the taxable year" the amount of the unearned premiums shall include (1) life insurance reserves as defined in section 201(c)(2) and section 29.201-4 pertaining to the life, burial, or funeral insurance, or annuity business of an insurance company subject to the tax imposed by section 204 and not qualifying as a life insurance company under section 201(b), and (2) liability for return premiums under a rate credit or retrospective rating plan based on experience, such as the "War Department Insurance Rating Plan," and

which return premiums are therefore not earned premiums. * * *

7 Oregon Compiled Laws Annotated (1940)

SEC. 101-105.—*General powers and duties of commissioner.* (1) The insurance commissioner shall have and exercise the power to enforce all the laws of the state relating to insurance, and it shall be his duty to enforce all the provisions of such laws for the public good. He shall issue such department rulings, instructions and orders as he may deem necessary to secure the enforcement of the provisions of this act, but nothing contained in this act shall be construed to prevent any company or persons affected by any order or action of the insurance commissioner from testing the validity of same in any court of competent jurisdiction.

* * * * *

(3) [Furnishing of form for financial statement.] Every insurance company, doing business in the state, shall file with the commissioner, on or before March 1st of each year, a financial statement for the year ending December 31st immediately preceding on [a] form furnished by the commissioner, which shall conform as nearly as may be to the form of statement from time to time adopted by the national convention of insurance commissioners, and containing such detailed exhibit of the condition and transactions of the company as the commissioner, in such form and otherwise shall reasonably prescribe. Such statement shall be verified by the oaths of the president and secretary of the company, or in their absence by two other principal officers. The statement of a company of a foreign country shall embrace only its condition and transactions in the United States, and shall be verified by the oath of its

resident manager or principal representative in the United States. In the discretion of the commissioner, a penalty of ten dollars per day shall attach for delinquency in filing such statement.

* * * * *

SEC. 101-136. (*Examination into affairs of company or persons in insurance business: Appointment of examiners: Duty to produce books and papers and to facilitate examination: Report of examiners: Hearing: Inspection and publication of report: Expenses of examination.*) The insurance commissioner shall, whenever he deems it advisable in the interest of policyholders or for the public good, examine into the affairs of any insurance company, agency, corporation, partnership, person or persons engaged in or proposing to engage in the insurance business of this state, and into the affairs of any company organized under any law of this state or having an office or representative in this state, which company is engaged in or is claiming or advertising that it is engaged in organizing or receiving subscriptions for or disposing of stock of, or in any manner aiding or taking part in the formation or business of an insurance company or companies, or which is holding capital stock of one or more insurance companies for the purpose of controlling the management thereof as voting trustee or otherwise. * * * It shall be the duty of the insurance commissioner to examine every domestic insurance company at least once in three years.

SEC. 101-137. *Examination: Reserve: Liability:* (*Formulating or adopting rules*). In ascertaining the condition of an insurance company under the provisions of this act, or in any examination made by the insurance commissioner, his deputy, or examiner, he shall allow

as assets only such investments, cash and accounts as are authorized by the laws of this state at the date of the examination, or under the existing laws of the state or country under which such company is organized and which investment he may approve or reject, but unpaid premiums on policies written within three months shall be admitted as available resources. In ascertaining his liabilities, unless otherwise provided in this act, there shall be charged the capital stock, all outstanding claims, a sum equal to the total unearned premiums on the policies in force computed on a pro rata basis, and such an amount as may be found necessary as a reserve to provide for the future payment of deferred and undetermined claims for losses and promised benefits. In determining the amount of such reserve or unearned premium liability, the insurance commissioner, his deputy or examiner may formulate such rules as he may deem proper and consistent with law or he may adopt such rules as are used in other states or approved by the national convention of insurance commissioners.

SEC. 101-138. *Revocation of certificate or license: Court review.* (1) If the commissioner shall find upon examination or other evidence that any insurance company is in an unsound condition, or that it has failed to comply with the law or with the provisions of its charter or articles of incorporation or association, or that its condition is such as to render its proceedings hazardous to the public or to its policy-holders, or that its actual assets exclusive of its capital are less than its liabilities, or if its trustees, directors, officers, or agents refuse to submit to examination or to produce at the office where the same are kept, its books, records, accounts, and papers in its or their possession or control relating to its business or affairs, for examination and inspection

of the commissioner, his deputy or examiner, when required, or shall refuse to perform any legal obligation relative to such examination, the commissioner shall revoke or suspend all certificates of authority and licenses granted to such insurance company, its officers or agents, and shall cause notice thereof to be given to such company and to each agent of such company in this state and no new business shall thereafter be done by such company or for such company by its agents, in this state, while such revocation, suspension, or disability continues, nor until its authority to do business is restored by the commissioner.

* * * * *